No. 12550

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

MAY CHANDLER GOODAN,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

MARIAN OTIS CHANDLER,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

NORMAN CHANDLER,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

PHILIP CHANDLER,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

CONSTANCE CHANDLER CROWE,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

HELEN CHANDLER GARLAND,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

RUTH C. WILLIAMSON,

Respondent.

BRIEF FOR THE RESPONDENTS.

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BRIEF FOR THE RESPONDENTS.

Opinion Below.

The opinion of the Tax Court [R. 29-70] is reported at 12 T. C. 817.

Jurisdiction.

A notice of deficiency was mailed by the Commissioner of Internal Revenue to each of the respondents on June 30, 1943, proposing deficiencies in individual income taxes for the calendar years 1938, 1939, 1940, and 1941. [R. 8-16, 92-101, 116-127, 142-154, 171-179, 195-203, and 219-228.] A petition to the Tax Court of the United States was filed by each respondent on September 27, 1943, pursuant to and within the 90-day period prescribed by Section 272(a) of the Revenue Act of 1938 and Section 272(a) of the Internal Revenue Code. [R. 2-16, 86-101, 110-127, 136-154, 163-179, 189-203, and 212-228.] Issue was joined by the filing of the Commissioner's answers on November 17, 1943. [R. 17-19, 102-104, 128-130, 154-157, 180-184, 204-206, and 228-231.]

The Tax Court's opinion (12 T. C. 817) was promulgated May 17, 1949 [R. 29-70], and on May 24, 1949, a decision was entered in each proceeding. On June 7, 1949, the Commissioner of Internal Revenue filed a motion to vacate said decisions [R. 71-73], and said decisions were vacated by order of the Tax Court dated August 15, 1949 [R. 74]. On November 30, 1949, the Tax Court entered an order denying the Commissioner's motion to reconsider and set aside the findings of fact and opinion, together with a memorandum explaining its reasons for the denial [R. 75-80], and on the same day, November 30, 1949, it entered a decision in each case in conformity with the decision theretofore vacated [R. 81, 105, 131, 157-158, 184, 207,

and 232].* Petitions for review of said decisions were filed by the Commissioner of Internal Revenue on February 17, 1950 [R. 82-83, 106-107, 132-133, 158-160, 185-186, 208-209, and 233-234], pursuant to Section 1141 of the Internal Revenue Code and within the 3-months' period specified in Section 1142 of the Internal Revenue Code. The respondents' tax returns for the years in question were filed with the Collector of Internal Revenue for the Sixth District of California, at Los Angeles, California. [R. 2 and 17, 86 and 102, 110 and 128, 136 and 154, 163 and 180, 189 and 204, and 212 and 229.]

Statutes and Regulations Involved.

The pertinent provisions of the applicable statutes and Regulations involved are set forth in the Appendix.

Questions Presented.

1. Whether the Tax Court's determination that certain stock dividends were required to be retained as corpus of a trust and could not be distributed to the respondents as beneficiaries of the trust was an erroneous interpretation of the Trust Agreement.

2. Whether the Tax Court was correct in its determination that the trust as a separate entity should be respected for tax purposes and that the individual respondents, there-

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*As stated on page 2 of the Commissioner's brief, the record prints some of the decisions entered on May 24, 1949, and others entered on November 30, 1949. Decisions were entered in each case on both dates, but the decision entered in each case on November 30, 1949, was identical to the decision in that case entered on May 24, 1949.

fore, should not be subjected to income tax upon stock dividends which they did not and could never individually receive.

Statement.

The Commissioner's statement of the case, consisting largely of a digest of the Trust Agreement, is a repetition of the facts as found by the Tax Court, which in turn were based upon the facts as stipulated by the parties. Inasmuch as the respondents do not controvert any of those facts, we shall not repeat them here. We desire, however, to state briefly the background giving rise to the present problem.

Chandis Securities Company was organized in 1916. [R. 25.] It fell within the definition of a personal holding company under the subsequently-enacted personal holding company surtax provisions of the revenue laws, which levy a special surtax upon income of a personal holding company that is not distributed to its stockholders. Under the Revenue Act of 1936 the tax on such undistributed earnings was not prohibitive, amounting to only 18% of the undistributed income up to $100,000.00 in any one year. See Section 351(a)(2) of the Revenue Act of 1936. The rate was drastically increased by the Revenue Act of 1937, applicable to years beginning in 1937, so that the first $2,000.00 of undistributed income was taxed at the rate of 65% and all undistributed income in excess of $2,000.00 was taxed at 75%. See Section 1 of the Revenue Act of 1937. And those high rates remained in effect under Section 401 of the Revenue Act of 1938.

Chandis Securities Company was indebted to a bank in a very substantial amount on its own obligations and obligations of its wholly-owned subsidiary, the Southwest Land Company. [R. 50.] By reason of the terrific increase in personal holding company surtax rates in 1937, the company was placed in a dilemma. For practical purposes it became impossible for the company to retain its earnings for the liquidation of its obligations and those of its wholly-owned subsidiary, for three-fourths of any earnings thus retained would be taken by the Government in taxes and only 25% would be left with which to liquidate the indebtedness.

The purpose of the personal holding company tax, of course, was to force personal holding companies to distribute their earnings so that tax on the dividends would be collected from the stockholders.

The Chandis Securities Company met this problem in what seemed to be the only practicable way under the statute. It had outstanding only common stock. By authorizing the issuance of new preferred stock and distributing such preferred stock to the holders of the common stock, a taxable stock dividend would result. This would satisfy the purposes of the personal holding company surtax, in that ordinary dividend tax would be paid by the stockholders upon the earnings of the company, but at the same time the corporation would be permitted to retain a portion of the cash earnings represented by the preferred stock and could apply such cash earnings toward the payment of the obligations mentioned.

This course was adopted. During each of the years 1937, 1938, 1939, 1940, and 1941 a portion of the earnings of Chandis Securities Company was distributed as cash dividends, while such earnings as were needed to pay the obligations referred to were retained by the company and an equivalent amount of preferred stock was distributed on the common stock. [R. 50.] Although it does not appear in the record, the obligations have now long since been discharged and the consequent necessity of retaining cash earnings through distribution of taxable preferred stock dividends has been eliminated.

That this method of retaining cash needed by a corporation in its business or to pay debts was wholly legitimate and sanctioned by Congress and the Courts is reflected in the following quotation from *Helvering v. Griffiths,* 318 U. S. 371:

> "On March 3, 1936, the President had suggested the enactment of a tax upon the undistributed income of corporations. * * *
>
> * * * * * * * *
>
> "At the hearings of the Congressional Committees the proposed tax was attacked as being a measure which would have the effect of forcing the distribution by corporations of assets needed in their business. Its supporters anticipated the decision of this Court in the Koshland Case and countered with statements that dividends taxable as income to the shareholders—which would have the effect of avoiding the undistributed profits tax on the corporation—could be declared and the undistributed profits tax avoided without the necessity of distributing assets. * * *"

The controversy in the present cases arises because 35,394 of the outstanding 38,288 shares of common stock of Chandis Securities Company were owned and held by the Chandler Trust No. 2, which had been created on June 26, 1935. The preferred stock distributed on the common shares held by the trust were issued in the names of and delivered to the trustees; and since the Trust Agreement contained the rather common provision that stock dividends should inure to or fall upon principal such preferred stock was added to corpus of the trust and has been so held to this date. The trust reported the stock dividends as taxable income which was not distributed or distributable to the beneficiaries and hence the trust itself paid substantial income taxes on such income. [R. 47-50.]

The Commissioner of Internal Revenue sought to tax such stock dividends to the eight individuals who created the trust, seven of whom are the respondents here, upon the grounds (1) that they could amend the Trust Agreement in such a way as to permit the distribution of the stock dividends to themselves individually (hence subjecting them to tax under Section 167 of the Revenue Act of 1938 and of the Internal Revenue Code), or (2) that the existence of the trust should be ignored for tax purposes and the individual grantors should be treated as the owners of the trust corpus under Section 22(a) of the Revenue Act of 1938 and of the Internal Revenue Code within the doctrine of *Helvering v. Clifford,* 309 U. S. 331.

The Tax Court, however, held that the Trust Agreement forbids any amendment that would permit distribution of

the stock dividends and hence Section 167 is not applicable. This interpretation of the Trust Agreement is the one the taxpayers, parties to the agreement, have always maintained as reflecting their intent. But we have the curious situation here of an outside party—the Commissioner of Internal Revenue—arguing before this Court that such interpretation of the instrument is erroneous; that the taxpayers possess a power they never have thought they possessed, a power they never intended to possess, a power they do not want, and a power the exercise of which would go a long way toward nullifying the very purpose they intended to accomplish by creation of the trust. The taxpayers maintain that the Tax Court's interpretation of the Trust Agreement was correct and should be affirmed by this Court.

With respect to Section 22(a), the Tax Court held that the trust was established for a legitimate business purpose, with no thought whatever of reducing income taxes; that each individual grantor executed the Trust Agreement for the very purpose of surrendering important and substantial attributes of ownership theretofore enjoyed by him as owner of his shares; that he did not in substance or in fact remain the owner of his share of the trust corpus; and hence it would be improper to tax him upon the stock dividends as if the trust had not been created. The taxpayers contend that these conclusions were eminently sound and should be affirmed by this Court.

Summary of Argument.

1. Eight individuals, of whom seven are the respondents here, owned certain shares of stock of The Times-Mirror Company and Chandis Securities Company. They created a trust in 1935 and each contributed his shares of such stock as corpus of the trust. The trust is irrevocable and is to terminate only upon the death of the last survivor of the grantors and their children who were living upon creation of the trust—21 individuals in all, ranging in age from two months up to 68 years. The principal purpose of the trust was to hold and conserve the shares of stock until termination of the trust. No amendment of the trust could be effective, directly or indirectly, to change the initial character of the trust estate or the duration of the trust. Stock dividends were required to be added to corpus of the trust. The Tax Court correctly held that stock dividends received by the trust could never be distributed to the grantors of the trust and hence such stock dividends were taxable to the trust and not to the grantors under Section 167 of the Revenue Act of 1938 and the Internal Revenue Code. The Tax Court also correctly held that Section 167 does not apply by virtue of a power to appoint the corpus, including accumulated stock dividends, after the death of a grantor.

2. The trust involved here was created for purposes diametrically opposed to those for which trusts are created under the doctrine of *Helvering v. Clifford,* 309 U. S. 331. Each grantor intended, by creation of the trust, to surrender, and did surrender, his absolute ownership of his

shares of stock for a wholly legitimate business purpose, as the Tax Court held, and with no thought whatever of savings in income taxes or estate taxes. The trust was not created, as is the usual *Clifford*-type trust, in an effort to create two or more taxable units where there is in substance but one economic unit, retaining as much dominion and control as possible and still effect a savings in surtax. The stock dividends in question did not remain for distribution within an intimate family group consisting of one economic unit, but are dedicated to be held for decades as corpus of a trust, for as long a term as is permitted by the laws of California. The Tax Court correctly appraised the realities of the situation in holding that each of the eight trustees was independent of the others and in deciding that the existence of the trust should not be ignored for tax purposes. Its decision that each grantor did not remain in substance the owner of his contribution to the trust corpus should be affirmed.

3. In the alternative, the respondents would not be taxable upon the stock dividends under the Commissioner's regulations subsequently adopted, and they are entitled to the benefit of his announced policy not to tax grantors of trusts for earlier years if they would not be taxable in subsequent years under the regulations.

ARGUMENT.

I.

The Tax Court Correctly Interpreted the Trust Agreement as Forbidding Distribution of the Stock Dividends to the Individual Respondents, and Correctly Held That Section 167 of the Revenue Act of 1938 and the Internal Revenue Code Does Not Apply.

The Commissioner's argument that the grantors should be taxed under Section 167 of the Revenue Act of 1938 and of the Internal Revenue Code is his second argument, on pages 37 to 41 of his brief. Logically, however, we feel that this matter should be decided first, for the alleged power to have the stock dividends distributed to the grantors is also one of the factors the Commissioner stresses in attempting to apply Section 22(a) of the Revenue Act of 1938 and of the Internal Revenue Code. See pages 32-34 of his brief. Hence, we prefer to answer this contention first.

The provision of the Trust Agreement which requires that stock dividends shall "inure to or fall upon principal" appears in Article VI(6)(a). Article IX of the agreement, after specifying that the trust shall be irrevocable, provides that the trustors during their joint lives can by their unanimous agreement in writing amend or modify the provisions of Articles II, III, V, VI, VII, and IX. Hence, the Commissioner reasons, the trustors by unanimous agreement can amend Article VI to provide that stock dividends should be deemed to be income, not to be added to corpus but distributable to the present beneficiaries. Hence, he argues that within the meaning of Section

167 the stock dividends may be distributed to the grantors or are held or accumulated for future distribution to the grantors.

But Article IX, after granting the power to amend by unanimous agreement, follows immediately with this limitation:

> "* * * but no such modification shall be effective, directly or indirectly, to change the provisions as to the duration of this trust or the initial character of the Trust Estate, as provided in Articles I, IV, and VIII, the provisions of which last numbered Articles shall in all respects and in each and every provision thereof be and remain irrevocable."

Hence, no modification of any Article in the Trust Agreement can be effective, directly or indirectly, to change the "initial character" of the trust estate.

What is the "initial character" of the trust estate? The introductory clause of the Trust Agreement recites that the trustors desire to unite and vest in the trustees "the *interests* of each of the trustors in said corporations," and that there should be "held, conserved, administered and eventually distributed, * * * those *assets* which are respectively contributed by them to the Trust Estate." It also recites that the trustors have delivered and assigned to the trustees certain *certificates representing shares* of the capital stock of the two corporations, and that *said personal property* shall be deemed to be the trust estate. Following such introductory provisions, Article I specifies that the trust estate shall be deemed to be segregated into two parts, one part consisting "of all of the *shares* of the capital stock of the Times-Mirror Company delivered to the Trustees hereunder" and the other consisting "of all

of the *shares* of the capital stock of Chandis Securities Company delivered to the Trustees hereunder."

In other words, the "initial character" of the trust estate consisted of shares of stock—to wit, 35,394 shares of the outstanding 38,288 shares of common stock of Chandis Securities Company, and 350 shares of the outstanding 5,760 shares of stock of the Times-Mirror Company.

The Commissioner, by confusing "certificates" with "shares," argues in effect that the initial character of the trust estate consisted only of the particular *certificates* that were delivered by the grantors to the trustees, and that no matter how much the *shares* represented by those *certificates* might be diluted with stock dividends the initial character of the trust estate would not be changed so long as the original *certificates* remained on hand with the trustees. Thus, on page 33 of his brief the gist of the Commissioner's argument is found in the following sentence:

> "Obviously, the stock dividends were not part of the initial trust estate and to distribute them would not change its initial character or terminate the trust. * * *"

Here we have exposed the fallacy in the Commissioner's position. Suppose either corporation desired to split up its stock into smaller units and accomplished this result by distributing stock dividends of say 10 new shares on every outstanding share of stock, or even 100 shares for one. The Commissioner's position is that the grantors could amend the trust and take unto themselves the 10 shares or the 100 shares for every share held by the trust, and that this would not change the "initial character" of the trust estate. Such a procedure obviously would reduce the share

in the corporation represented by the certificates delivered to the trustees to merely 10% or 1% of the share represented by those certificates before such a distribution. Instead of owning roughly 35,000 out of 38,000 shares, if the Commissioner's position is correct the trust would own only 35,000 out of 380,000 shares or even 3,800,000 shares. For the Commissioner to contend that this would not change the initial character of the trust estate is absurd. The "initial character" of the trust estate obviously has reference to the substantive shares contributed to the trust and not merely the paper evidence or certificates representing those shares.

Fletcher's Cyclopedia Corporations, Volume 11, Chapter 58, Section 5083, page 28, draws the distinction between shares of stock and certificates as follows:

> "A share of stock is one of the proportionate integers or units of the capital stock, and is the interest or right which the owner or holder thereof has in the management of the corporation and to share in the profits thereof and in the property and assets thereof on dissolution, after the payment of the corporate debts and obligations."

And Section 5092, pages 55-56:

> "It is well settled that a certificate of stock in a corporation is not the stock itself. It is the mere evidence of the holder's ownership of the stock and of his rights as a stockholder to the extent specified therein * * *."

The following quotations from Scott on Trusts, Volume 2, are sufficient to indicate that distribution of the stock dividends would change the initial character of the trust

estate. Thus, he states in Section 231.2, pages 1251 and 1252:

> "§231.2. Stock dividends. Where a trustee is authorized to retain certain shares of stock but is not authorized to purchase similar shares, and the corporation issues further shares to the shareholders as a stock dividend, the trustee can retain the new shares. In such a case he is not investing trust funds in the purchase of the shares, *but is merely maintaining the proportionate interest of the trust in the corporate undertaking.*" (Emphasis added.)

And in Section 236.3, page 1305, in discussing whether, in the absence of specification in the trust instrument, stock dividends should be treated as income or principal, the following comment appears:

> "One objection to allocating the whole or a part of a stock dividend to income is that even though there is no impairment of the value of the principal of the trust at the time of its creation, yet the proportionate interest of the trust estate in the corporation is diminished. * * *"

The same principle has been established by decisions of the United States Supreme Court. In *Gibbons v. Mahon,* 136 U. S. 549, 10 S. Ct. 1057, 34 L. Ed. 525, the Court said:

> "A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interests of the shareholders. Its property is not diminished and their interests are not increased. After such a dividend, as before, the corporation has the title in all the corporate property; the aggregate interests therein of all the shareholders are represented by the whole number of shares, and the proportional

interest of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original shares together representing the same proportional interest that the original shares represented before the issue of new ones."

Hence, the Tax Court in the present cases was eminently sound when it concluded as follows [R. 63-64]:

"* * * Reference to Exhibit 2-B attached to the stipulated facts shows that the preferred stock carried voting rights of one and three-sevenths votes for each share of preferred, as compared to one vote for each share of common. Any amendment by the trustors as a group that distributed the preferred stock would, therefore, destroy the proportionate interest that the trust had in Chandis. Such an amendment would change the initial character of the trust and would exceed the limited power of modification reserved by the trustors."

The Tax Court went further and advanced two additional reasons why the stock dividends could not be distributed to the grantors within the meaning of Section 167. It stated as follows [R. 64]:

"Another reason which makes any joint action by the trustors on the above amendment unlikely is the adverse interest of Norman Chandler. His personal interests would undoubtedly lead him to object to any modification that would hurt his chances to assume the presidency of The Times. Without his consent the other trustors would be powerless to modify the trust instrument in any particular.

"A third deterring factor in making any such amendment is the rights of the remaindermen. As hereinabove pointed out, California law would not

> permit the trustors to terminate the trust upon the theory that they were the only interested parties. If the trustors could amend so as to distribute a part of the trust corpus, they could amend so as to distribute the entire corpus and thus terminate the trust. The law will not permit the trustors to accomplish by indirection that which they can not do directly. We are of the opinion that any remainderman could, by proper court action, prevent the trustors from distributing the corpus to the life tenants. * * *"

In other words, the Tax Court correctly held that Norman Chandler, whose consent was necessary to any modification of the trust, would be adverse to an amendment which would permit the voting power of the stock held in the trust to be diluted. The Commissioner's brief, in a footnote on page 30, denies that Norman's interest would be adverse. But the Commissioner apparently misses the point. All he says is that if adverse interests were to develop later among the grantors that would be irrelevant. But the question is not whether a conflict might develop between the grantors. The question is, if one of the grantors should suggest that the trust be amended in such a way that stock dividends might be distributed to them, would such a proposal be contrary to Norman Chandler's personal interests? We maintain that the Tax Court correctly appraised the situation in holding that Norman Chandler, who was assured of lifetime occupancy of the presidency of the Times-Mirror Company under the trust as it was initially created, would be substantially adverse to an amendment which would dilute the voting power of the trust and which might thereby jeopardize his position.

The third reason, as expressed by the Tax Court in the above quotation, brings up another interesting point. One

of the principal contentions of the Commissioner before the Tax Court was that Chandler Trust No. 2 was not a valid trust, since no one had an interest in it other than the grantors themselves and hence they could terminate it at will. As the Commissioner states on pages 18 and 19 of his brief, the Tax Court held that the trust was a valid trust and that the trust could not be revoked under Section 166 of the Internal Revenue Code. The Commissioner does not challenge these determinations in his statement of points to be urged set forth on page 19 of his brief. He has abandoned his argument that a valid trust was not created, and he likewise has abandoned his argument that the trust is revocable.

Hence, the above quotation from the Tax Court is particularly significant here. Since admittedly the trust cannot be revoked or terminated by the grantors, the law will not permit them to do indirectly what they cannot do directly and hence California law would not permit the trustors to amend the trust so as to distribute a part of the trust corpus.

As a result of all the foregoing we believe the Tax Court correctly held that stock dividends could not be distributed to the grantors and were not held for future distribution to them within the meaning of Section 167.

The Commissioner's second argument for application of Section 167 is that as a result of the power of appointment reserved to each grantor the stock dividends could be appointed to his estate or to a creditor and hence he could realize the value of the stock dividends during his lifetime.

The Commissioner urges this Court to "consider the *realities* which exist in the case of a general power to appoint corpus, including income added thereto, *to take*

effect at death, by means of which the grantor may be able to enjoy the equivalent of the income during his life. * * *" (Pages 40 and 41 of his brief.)

The taxpayers, on their part, urge the Court to look at the realities of the situation, and we think it will become apparent that the Commissioner's position is about as *unreal* as could be imagined. Thus, we are told, one of these grantors could approach a prospective creditor or lender and say to him, "If you will give me the value of these stock dividends I will exercise my power of appointment in such a way that upon termination of the trust the stock dividends will be paid to you." How would the prospect respond to such a proposition?

In looking forward to the day when he might actually receive the stock dividends, the lender or creditor would not merely be speculating upon when the particular grantor would die, for the trust will not terminate on his death. It would be necessary to take into account the fact that the lender or creditor could acquire the stock dividends only upon the death of the last survivor of 20 other individuals. When the trust was created in 1935 these other individuals ranged in age from two months up to 68 years. Seven of the grantors ranged from 28 to 42 years of age. Six other persons whose lives measure the duration of the trust were between 10 and 18 years of age. Six others ranged from three to eight years of age. The stock dividends could be distributed to the prospective lender or creditor only after all of these 21 persons had died.

How long would that be? Certainly 50 years would be a most conservative estimate—probably much longer. The reality of the situation is that a prospective lender or creditor would undoubtedly view the probability that he himself would be dead before the stock dividends could be dis-

tributed to him. How much would he pay a grantor for such a dubious investment?

Mere length of time, however, would not be the only deterrent. What value, if any, would the stock dividends possess 50 years from now—any stock, for that matter? We think it is obvious that a person with means would not invest a nickel in such a proposition.

Hence, the taxpayers vigorously challenge, as a matter of actual fact and reality, the Commissioner's easy assumption that by means of a general power to appoint the corpus, including the stock dividends, the grantor may be able to enjoy the equivalent of the stock dividends during his life. Such a position, instead of dealing with realities, escapes to the realm of theoretical speculation. It ignores actualities.

It would be no answer for the Commissioner to assert, and he does not assert, that Section 167 applies because the grantor could appoint not only the stock dividends but also the income those stock dividends might produce after his death. Section 167 is concerned with the possible distribution of the stock dividends themselves and not with future income those stock dividends may hereafter produce.

Thus, as applied to this case, Section 167 provides that if the stock dividends are "held or accumulated for future distribution *to the grantor*," or may be "distributed *to the grantor*," such stock dividends shall be taxed to the grantor.

In the first part of this reply we demonstrated that the stock dividends cannot be distributed *to the grantors* and cannot be held or accumulated for future distribution *to the grantors*.

So, as an alternative, the Commissioner argues that the power to appoint the stock dividends after a grantor's death

and upon termination of the trust is the equivalent of having the stock dividends distributed to the grantor's estate, and that Section 167 should be construed to apply to income which will revert, not to the grantor himself, but to his estate.

Such an interpretation of Section 167 has been uniformly rejected. In *Lady Marian Bateman,* 43 B. T. A. 69, affd. (C. A. 1) 127 F. 2d 266, 5 per cent of the trust income was to be accumulated and the grantor reserved a power to appoint the trust corpus after her death. The Board of Tax Appeals held that Section 167 did not apply to such accumulated income, saying:

> "* * * The accumulation became part of the corpus and could never come into the hands of petitioner. We have been cited to no authority and we find none for the proposition that an accumulation of trust income which may at most redound to the benefit of the grantor's heirs requires taxation of the grantor under section 167. In fact, the contrary has just been held in *Antoinette K. Brown,* 42 B. T. A. 693."

And the Circuit Court, in affirming the Board on this point, stated as follows on page 269:

> "Nor is the five per cent of the net income being 'held or accumulated for future distribution to the grantor' within the meaning of §167. This income was added to the principal by the mandatory provision of the trust instrument and will ultimately come to Lady Bateman's testamentary appointees or else in default of appointment to her next of kin by the New York law. In no event can such income be distributed 'to the grantor'. On this point we agree with the conclusion of the Board in John P. Wilson v. Commissioner, 1940, 42 B. T. A. 1260, 1266."

The Commissioner is also foreclosed on this point by *Mary W. Pingree,* 45 B. T. A. 32, where the trustor had reserved a power to appoint the corpus upon termination of the trust; and the Commissioner contended that capital gains realized by the trust and added to corpus under State law should be taxed to the trustor under Section 167. The Board rejected this argument with the following statement:

> "* * * Amounts thus accumulated were never to be distributed to the petitioner and, consequently, section 167 has no application. * * *" (P. 35.)

To the same effect is *Walter S. Halliwell,* 44 B. T. A. 740, reversed on other grounds, *Commissioner v. Halliwell* (C. A. 2), 131 F. 2d 642.

On page 40 of his brief the Commissioner argues that the *Bateman* case was incorrectly decided, for it "failed to consider the realities which exist * * *." We have shown above that the Commissioner is the one who fails to consider the realities that exist in the present circumstances. The Commissioner also calls attention to the fact that the *Wilson* case, which was cited by the Circuit Court in the *Bateman* case, was subsequently reversed in *Commissioner v. Wilson* (C. A. 7), 125 F. 2d 307, and the Commissioner alleges that:

> "* * * the Seventh Circuit's decision *to some extent* supports the view that future distribution to the estate of a grantor will satisfy Section 167."

This is all the authority the Commissioner can muster in support of such an extension of the plain words of Section 167, but the fact is that the *Wilson* case furnishes no support whatever for an argument that distribution to the estate of a grantor will satisfy Section 167.

The capital gains in the *Wilson* case were accumulated as part of the corpus of the trust. The trust was to

terminate upon the death of the life beneficiary, the grantor's daughter, or when her youngest surviving child, if any, attained the age of 20. Upon such termination the trust corpus, including accumulated capital gains, was to be paid to the grantor, if living, otherwise to his estate. The Seventh Circuit held that the capital gains were taxable to the grantor as follows:

> "* * * Under such circumstances it seems clear that the case of Graff v. Commissioner, 7 Cir., 117 F. 2d 247, is controlling. In that case the capital gains were not distributed to the beneficiary, but were added to the corpus to be paid to the grantor upon the death of his wife, if he was then living, and, if he was not then living, the trustees were to divide the corpus and pay same to the grantor's children. We held that the capital gains were income accumulated for future distribution to the grantor within the meaning of §167(a)(1)."

Thus, the *Wilson* case was decided solely upon the authority of the *Graff* case; and in the latter case there was no provision at all for payment of the accumulated income to the estate of the grantor. Such income was to be paid upon termination of the trust to the grantor, if living, otherwise to alternative remaindermen. The whole basis of the decision was that Section 167 applies by virtue of the possibility that the income may be distributed *to the grantor* personally. His estate was not even involved. Since the same possibility existed in the *Wilson* case—*i. e.,* distribution to the grantor personally—that factor obviously was the sole basis of the Court's decision.

Hence, we submit that there is no authority whatever for the Commissioner's contention that distribution to the estate of a grantor will satisfy Section 167.

It follows that the Tax Court correctly interpreted the Trust Agreement in the present cases as forbidding any distribution of stock dividends to the respondents and correctly held that such stock dividends were not taxable to them under Section 167 of the Revenue Act of 1938 and of the Internal Revenue Code. Its decision should be affirmed.

II.

The Tax Court Correctly Held That Chandler Trust No. 2 Should Not Be Ignored for Tax Purposes, That Each Individual Respondent Ceased to Be the Owner of the Assets Contributed by Him to the Trust, and That Each Individual Respondent Therefore Is Not Taxable Under Section 22(a) of the Revenue Act of 1938 and the Internal Revenue Code Upon Stock Dividends Received by the Trust.

The Commissioner points out on pages 22 and 23 of his brief that the leading case on this point is *Helvering v. Clifford,* 309 U. S. 331. In that case the trust was to exist for only five years. The sole grantor named himself the sole trustee. During the five years he could pay to his wife as much of the trust income as he wished. At the end of the five years the trust corpus was to revert to the grantor, and any accumulated income was to go to the wife. The same disposition of corpus and income would follow upon termination of the trust within the five years, upon the death of either the grantor or his wife.

The Commissioner at the top of page 23 of his brief states that the Supreme Court reaffirmed the rule:

> "* * * that legal technicalities or niceties of the law of trusts or conveyances should not be allowed to obscure the basic issue in tax cases, and pointed

> out (p. 334) that where the grantor is the trustee and the beneficiaries are members of his family group, special scrutiny of the arrangement is necessary, for purposes of determining whether the grantor is taxable on trust income under Section 22(a)."

This is not quite what the Supreme Court said in the *Clifford* case; and if we go back to the exact language we will find that the words omitted in the above quotation are particularly significant here and point to the opposite conclusion in the present cases. What the Supreme Court actually said on pages 334 and 335 is as follows, and we have italicized the significant language which is omitted from the Commissioner's brief:

> "* * * Technical considerations, niceties of the law of trusts or conveyances, or the legal paraphernalia *which inventive genius may construct as a refuge from surtaxes* should not obscure the basic issue. * * * And where the grantor is the trustee and the beneficiaries are members of his family group, special scrutiny of the arrangement is necessary *lest what is in reality but one economic unit be multiplied into two or more* by devices which, though valid under state law, are not conclusive so far as §22(a) is concerned."

In other words, the *Clifford* case was an out-and-out tax avoidance plan. The Supreme Court recognized it and dealt with it as such. The whole gist of the case was that, with steeply graduated surtax rates, special scrutiny is necessary "lest what is in reality but one economic unit be multiplied into two or more," and that the Commissioner is not bound by legal technicalities which inventive genius may construct "as a refuge from surtaxes."

The Commissioner argues, however, that the theory of the *Clifford* case is not limited to a small family living under one roof, but can apply, as here, to members of an adult, grown family each living in separate households and each contributing assets to a trust. This argument misses the whole point of the *Clifford* case, namely, that a grantor will not be permitted to create two taxable units where in substance only one economic unit remains. Obviously, in the present cases, before the Chandler Trust No. 2 was created we had more than one economic unit. We had eight economic units. Each grantor lived separate and apart from the other, with his or her own spouse and in most instances with children. Each owned certain shares of stock. Each was taxable upon the income from his or her shares of stock without any relation whatever to the other grantors. Thus, before the trust was created there were eight economic units and there were eight taxable units. In creating the trust, therefore, each grantor did not attempt, as did Clifford, to divide his own little economic unit into two taxable units in order to reduce his surtaxes.

Continuously, since at least the Revenue Act of 1918, the revenue laws of the United States have recognized trusts as separate entities for tax purposes and have provided, substantially in accordance with what is now Sections 161 and 162 of the Internal Revenue Code, that the personal income tax imposed by the Code "shall apply to the income of estates or of any kind of property held in trust * * *." Section 162 specifies that the net income of a trust shall be computed in the same manner as in the case of an individual, except that a trust is allowed to deduct sums distributed or distributable to beneficiaries, which sums are then taxed to the individual beneficiaries of the trust.

There have always been two limitations upon this recognition of a trust as a separate taxable entity. (1) If the grantor can revoke the trust he is taxed upon its income, which seems only just, since he has the power to receive the income whether he sees fit to do so or not. Section 166 of the Internal Revenue Code. This was the situation in *Gaylord v. Commissioner* (C. A. 9), 153 F. 2d 408, where the grantor had failed to make the trust irrevocable and hence under California law it was revocable by him at will. The Commissioner does not contend that the present trust is revocable, and obviously it is not. (2) If the grantor can cause the income to be distributed to him or accumulated for future distribution to him he is taxable upon such income; here, again, upon the rational theory that he should be taxed upon income which is his for the taking. Section 167 of the Internal Revenue Code. We have shown above that this Section does not apply to the present cases.

As surtax rates were graduated more steeply, the fact that a trust was recognized as a separate taxable entity presented an opportunity to attempt to create two taxable units and thereby decrease surtaxes through a trust in which the grantor would retain as much control and ownership as possible. As we have stated, the *Clifford* case was typical of that type of endeavor.

The striking feature of the present case is that Chandler Trust No. 2 was created for reasons diametrically opposed to the purposes which prompt the establishment of the *Clifford*-type trust.

Chandler Trust No. 2 was created for the very purpose of having the grantors surrender rights, powers and control which they theretofore possessed as individual owners of the stock of the two corporations; and to do this without

any thought whatever of reducing either income tax or estate tax. The ordinary income of the trust is distributable to these grantors currently and is therefore taxed to them to the same extent as if the trust had not been created. Provision for such distribution to the grantors would have been ridiculous if they had created the trust to form two taxable units and thus avoid income taxes. It would also have been ridiculous if they had sought to reduce estate taxes, for the same reservation of income for life will subject each trustor's share of the corpus to estate tax under Section 811(c) of the Internal Revenue Code. Hence we feel that the Commissioner's implication of attempted tax avoidance here (page 24 of his brief) is particularly unwarranted.

The trust was created to serve a wholly legitimate and proper purpose. It was prompted by the very fact that the stock in question was not owned by an intimate family group or by one economic unit—which constituted the basic factual background for the *Clifford* case and upon which such emphasis has been placed in later cases. The Chandler family had grown to maturity and constituted many separate family and economic groups when the trust was created in 1935, as we have noted. Prior to creation of the trust these adults each owned stock of The Times-Mirror Company and Chandis Securities Company. As individuals they enjoyed untrammeled rights of ownership. Each could vote his stock as he pleased; he could sell it or give it away; he could pledge it as security for loans; he could exercise any of the privileges of an owner.

The trust was created so that each individual thenceforth would not possess these attributes of ownership—so that he could not vote it as he pleased, give it away, sell it, pledge it or otherwise permit it to fall into the hands

of creditors or other outside interests. Each committed himself to turn over the management of the business to Norman Chandler, and agreed that this could be changed only by the unanimous consent of all eight individuals, including Norman Chandler himself, who normally might be expected to oppose any such change.

In short, these eight individuals intended by the creation of Chandler Trust No. 2 to reduce their rights from those of outright owners to those merely of life tenants with powers to appoint the remainders.

The three factors that were stressed by the Supreme Court in *Helvering v. Clifford,* 309 U. S. 331, were (1) the short term of the trust (five years); (2) the fact that the income sought to be taxed remained in the family group, which before and after the trust was but one economic group; and (3) the complete control reserved to the one individual who was both grantor and trustee. In the present cases (1) the trust is to last during the lives of 21 individuals—as long a term as is permitted by the laws of California; (2) the income sought to be taxed did not remain in any intimate family group (it consisted of stock dividends which were required to be treated as corpus and therefore can go to no one until termination of the trust, decades hence); and (3) the very purpose of the trust was to surrender and relinquish the unlimited rights of ownership.

To apply the *Clifford* doctrine to the present facts would extend that doctrine beyond anything that it has heretofore been thought to cover. We submit that the Commissioner's determination cannot be defended.

After discussing the *Clifford* case, the Commissioner on pages 23 and 24 of his brief cites many cases where

individual grantors have been held taxable upon the income of trusts created by them. The underlying theme running through all of them, as the Commissioner's brief recognizes, is that each grantor in those cases reserved a power directly, in his capacity as sole trustee or through his ability to become the sole trustee or to direct the trustees, to determine who should enjoy the income of the trust from year to year during his lifetime. All these cited cases, therefore, fall within the general principle of which *Commissioner v. Buck* (C. A. 2), 120 F. 2d 775, is typical and is the leading case. It was there pointed out, as it has been pointed out in all the other cited cases, that complete control over the distribution of income *during a grantor's lifetime* is one of the substantial attributes of ownership. In other words, to "sprinkle income about" as the grantor chooses was seized upon in those cases as being perhaps the most important right retained by the grantors.

On page 34 of his brief the Commissioner urges that in the present cases the powers retained by the grantors were greater than those retained in the *Buck* and other cited cases. The Commissioner asserts that in the present case, as in the *Buck* case, the taxpayers, since they were to receive the ordinary income of the trust, could sprinkle it about as they chose. No one denies that, but it is entirely beside the point. On the income thus received each grantor, of course, has paid income tax. It was on that type of income that Buck attempted to escape tax. The income with which we are here concerned is the stock dividend income. The grantors, as we have shown, cannot receive the stock dividends. They cannot sprinkle the stock dividends about during their lifetime. Hence, the only income with which we are here concerned is not subject *during the lifetimes of the grantors* to such a power of distribu-

tion as was the income that was involved in the *Buck* and other cases.

And this very fact furnishes the chief basis for distinction between the cases cited by the Commissioner and the cases relied upon by the taxpayers here and by the Tax Court, to the effect that *the mere power to dispose of property after the death of a grantor is not such a power as was involved in the Buck case.* In other words, the Courts have drawn a clear distinction, in applying the *Clifford* doctrine, between a power to sprinkle income about during a grantor's lifetime, and a power merely to appoint after a grantor's death.

That distinction was very clearly stated in *Commissioner v. Bateman,* 127 F. 2d 266, and is a distinction which the Commissioner himself has adopted in his own regulations interpreting the *Clifford* doctrine. We are at a loss to understand why the Commissioner in this particular case should seek to abrogate the distinction which his own regulations have drawn. We shall discuss the regulations in the next section of this brief.

The *Bateman* case was relied upon by the Tax Court, and is attempted to be distinguished by the Commissioner on pages 35 and 36 of his brief.

In the *Bateman* case the taxpayer created a trust which provided that five per cent of the net income should be added to the trust corpus and the balance of the income should be currently distributed to the taxpayer-trustor. On her death the trust corpus was to be distributed as she should appoint by her Last Will or by any written instrument signed before two witnesses. Any appointment during her lifetime was revocable. In default of appointment, the property was to go to her blood relations under the

New York laws of intestacy. The taxpayer had borrowed $27,000.00 from the trust, giving her note and securities as collateral (and in this latter respect the case was of course much stronger for the Commissioner than the present cases).

The Board of Tax Appeals began its opinion by stating the issues as follows:

> "* * * Petitioner and respondent are at issue here solely in regard to the 5 percent of the trust income which, by the indenture, was to be added to corpus, there being no question, of course, that the balance of the income is taxable to petitioner. Concisely stated, respondent's position is that petitioner's reservation of the power to appoint the corpus makes her taxable on the entire income arising therefrom. From his brief it would appear that he is relying mainly on section 22(a) of the Revenue Acts of 1934 and 1936, and *Helvering v. Clifford,* 309 U. S. 331. He points specifically to petitioner's ability, as demontrated by her borrowings from the trust in 1932 and preceding years, to secure full economic benefits from the trust corpus merely by obtaining loans from the trustees and appointing sufficient of the trust corpus to the trustees to secure them." (P. 71.)

The issue was decided in favor of the taxpayer, notwithstanding her borrowing from the trust corpus, the Board stating at page 72:

> "* * * we are not impressed with respondent's contention that petitioner, by reserving a power to appoint the reversionary interest in the trust estate, retained such dominion over the corpus as to make her taxable under section 22(a). * * *"

The Court of Appeals for the First Circuit affirmed the Board in an exhaustive opinion. The case of *Commissioner v. Buck,* 120 F. 2d 775, had been decided earlier by the Second Circuit and had taxed to the grantor income which he had the power to sprinkle among the beneficiaries as he saw fit during his lifetime. The First Circuit stated:

> "* * * In contrast to the Buck case, she [Mrs. Bateman] cannot command the distribution of income or principal at any time during her lifetime to objects of her bounty. * * *" (P. 271.)

The gist of the First Circuit's opinion holding that Mrs. Bateman was no longer the substantial owner of the trust property is found on page 271 as follows:

> "* * * By the trust indenture the taxpayer irrevocably surrendered up control over investment and reinvestment of the corpus, and voting rights to the stock. In no event may she be revested with title to the corpus. She can no longer spend or give away the principal or the income during her lifetime. Assuming she has other property ample for her needs, it still is difficult to deny that as to the property she conveyed to trustees she gave up such substantial rights normally associated with the concept of 'full ownership' that she should no longer be deemed in substance the 'owner' of the corpus within the rationale of the Clifford case."

We respectfully submit that the same conclusion must be reached upon our parallel facts here, as the Tax Court held.

The Commissioner on page 36 of his brief attempts to distinguish the *Bateman* case upon the grounds (1) that there the trustees were two independent and disinterested parties, (2) the corpus of the trust did not consist of stocks

in corporations which the grantor controlled, and (3) the taxpayer there could not amend the trust to make the accumulated income distributable to her as an income beneficiary.

The distinctions, we submit, are without substance. As we have shown, the taxpayers here cannot draw down the stock dividends, and hence in that respect there is no distinction between these cases and the *Bateman* case. Nor did any grantor in this case, alone, control either of the corporations involved, either before the trust was created or after. The fact that the eight grantors together controlled the Chandis Securities Company after the trust was created is without significance. They controlled it together before the trust was created. In other words, before the trust was created no one grantor controlled Chandis but all of their stock taken together was sufficient for control. After the trust was created the trustees either unanimously or by majority vote could control Chandis, but this power obviously was not vested in any one grantor.

And finally we fail to see any distinction in substance between the cases in the fact that each grantor here was one of eight trustees. It is one thing to name the grantor as sole trustee of a trust created by him, with power to sprinkle income during his lifetime, but it is certainly an entirely different thing to join in a trust and become one of eight trustees and effectively surrender control during one's lifetime of the disposition of stock dividends with which we are here concerned.

The Commissioner argues on page 37 of his brief that this case is more analogous to *Klein v. Commissioner*, 4 T. C. 1195, affirmed *per curiam*, 154 F. 2d 58. A brief statement of the facts in the *Klein* case will reveal how very different it was from the present circumstances.

The taxpayer there was 37 years of age, married but without children. He was the sole stockholder and president of Empire Box Corporation. The trust, of which the taxpayer and a friend were co-trustees, was created under the following conditions, as stated in the Court's findings of fact:

> "In December 1939 the corporation was about to declare current and arrearage dividends upon its 7 percent preferred stock, of which petitioner held 1,497 shares. On December 8, 1939, the petitioner, knowing of the corporation's intention to pay current dividends of $3.50 per share and arrearage dividends in the amount of $60,756.50, created the trust hereinafter described. This he did after conferring with his personal attorney and a tax advisor. His purpose in creating the trust was to prevent himself from immediately putting back into the business of the corporation the proceeds of the anticipated dividends, a practice indulged in by him in the past which subjected his entire personal fortune to the full risks of one business, to avoid as much as possible taxation incident to the receipt of these dividends, and to minimize his future income taxes.
>
> "* * * The life expectancy of both petitioner and his wife was in excess of 20 years in 1939."

The declaration of trust provided that the income should be accumulated until the death of the survivor of the taxpayer and his wife or for 20 years, whichever first occurred. Following such period, the income was to be paid to the wife for her life, *or such other beneficiaries as the trustor should from time to time designate.* The trust was to terminate upon the death of the survivor of the trustor and his wife, or of the trustor alone if the

wife was not an income beneficiary, and the corpus was to be distributed as the trustor should appoint.

The trust reserved the following powers to the trustor:

> "* * * that the Trustor reserves the right and shall have the power at any time during his life by an instrument in writing delivered to the Trustees or upon his death by his last Will and Testament, to modify or alter this agreement by removing his then co-trustee and appointing another individual or trust company as co-trustee in the place and stead of the co-trustee so removed, by disposing of the distributable income of the trust estate as originally constituted, or as it may exist from time to time, otherwise than as originally provided in this indenture, by altering the proportion or amount of income to be paid to, or applied to the use of any one or more of the beneficiaries upon the termination of the period of accumulation, by cancelling any benefaction to any one or more of the beneficiaries, by substituting another beneficiary or beneficiaries in the place of any one or more of them, by adding to the number of beneficiaries, by providing for the proportion or amount of income to be paid or applied to the use of such additional or substitute beneficiaries upon the termination of the period of accumulation; * * *"

The Tax Court, after noting that the taxpayer relied upon the *Bateman* case, held as follows:

> "*However, that case, it is apparent, was much stronger for the taxpayer than is the one which is now before us.* In this case the settlor is also one of two cotrustees having broad administrative powers; he has the absolute power to remove his co-trustee; the original cotrustee and his designated successor were close business associates of petitioner;

> the corpus of the trust consisted of securities of a corporation completely dominated by petitioner; and the petitioner *settlor not only had the power to provide for the disposition of the accumulated income upon his death, but also had the power to designate the beneficiary or beneficiaries who should enjoy the income after 1959, if the trust should last that long (and that date was well within petitioner's life expectancy).*
>
> "We are of the opinion that the facts here present are more analogous to *Commissioner v. Buck, supra,* than to the *Bateman* case." (Emphasis supplied.)

The foregoing quotations make several points very clear: the first is that the Court casts no doubt upon the correctness of the *Bateman* case as applied to its own facts. The second is that the *Klein* case was more like the *Buck* case than the *Bateman* case, and hence more favorable to the Government. It should be borne in mind that the *Buck* case was decided before the *Bateman* case. The factors which made the *Klein* case more like the *Buck* case than the *Bateman* case are as follows:

1. The power to change the beneficial enjoyment of the income *during the grantor's lifetime*—instead of merely the power to appoint the remainder interests for enjoyment *after the grantor's death.* This is a vital distinction, and one that is observed even in the Commissioner's amended regulations on the *Clifford* doctrine, as shown hereinafter.

2. *Klein* had absolute administrative control over the trust, with complete power to remove the co-trustee, and he completely dominated the corporation the stock of which constituted the trust corpus. In the present case no one of the petitioners has such control over the administrative features of the trust nor over the corporations.

3. The *Klein* case trust was created for the purpose of accumulating income for 20 years, whereas in the present case the ordinary income is currently distributable. This difference calls for a difference in tax results even under the amended regulations, as hereinafter shown.

We submit that in all vital respects the present cases must be governed by the *Bateman* case and that the *Klein* and *Buck* cases are distinguishable, as indeed they were distinguished in the *Bateman* and *Klein* opinions, upon a distinction which the Commissioner has embraced in his regulations.

The Commissioner then asserts that the trustees of the present trust were not required or expected "to exercise the usual fiduciary powers of trustee," and on page 31 of his brief he challenges the Tax Court's holding that the trustees are "independent," asserting that they cannot be independent of themselves as trustors.

We submit that the Commissioner fails to analyze the situation. In rejecting his attempts to distinguish the *Bateman* case, the Tax Court stated [R. 59-60]:

> "We can not agree with the distinctions suggested by the respondent. The trust herein had as its principal purpose the family control of The Times stock so that Norman Chandler would be assured the presidency and general managership of The Los Angeles Times. This was a business, and not a tax-avoidance, purpose. The receipt by the trustor-beneficiaries of substantially the same cash income from the trust as they would have received had the property not been conveyed in trust also refutes the respondent's suggestion that the trust was created for tax-avoidance purposes. Nor are we impressed with the suggested distinction that each trustor did not convey to independent trustees. It is true that each trustor

> was a member of the Chandler family, but it is also true that each was an adult member of that family. The trust was not dominated by one or both parents, as is frequently true in trusts created for tax-avoidance purposes. We are convinced that the other seven trustees were independent of the trustor-trustee who conveyed the property."

The Commissioner's approach to this case flows from his inability or unwillingness to regard each of these taxpayers as an individual. He treats them as individuals to the extent that he would collect from each of them, individually, a substantial income tax; but in attempting to justify such an individual tax he forgets that each is an individual and regards them merely as members of a "closely knit family groups," each purportedly subservient to the wishes of the others.

But the doctrine of *Helvering v. Clifford, supra,* is not based upon such total disregard of individuals as entities. As the Board of Tax Appeals stated in *Estate of Frederick S. Fish,* 45 B. T. A. 120, 123:

> "* * * Even under such decisions as *Helvering v. Clifford,* 309 U. S. 331, the concept of family unity is an economic consideration rather than one of conduct or behavior. The inclusion in the husband's income of that derived from a trust of which members of his family are the beneficiaries results more from the view that family finances are a single unit generally furnished by the husband or father than that the action of individual members of the family group will necessarily accord with the dictates of its head. * * *"

The Commissioner here seeks to apply the *Clifford* doctrine of family unity as one of conduct or behavior. Thus,

he would treat each trustor in effect as the sole trustee, because the other seven co-trustees are related to him. But the Tax Court correctly appraised the situation and the true basis of the *Clifford* doctrine. When one of the trustors in this case conveyed his stock to himself and seven others as trustees, he certainly expected and directed the other seven to exercise whatever powers they possessed as trustee in a proper fiduciary manner. And that trustor certainly had no power to control the conduct or behavior of the seven other trustees, notwithstanding that they were his adult brothers and sisters. This is what the Tax Court meant when it held that each trustor conveyed his property in trust to "independent" trustees; and obviously its conclusion was correct. Thus, even the provision authorizing a trustee to deal with the trustees or with any corporation the stock of which is held in the trust is subject to this strict fiduciary limitation:

> "* * * so long as he, she or it shall fully disclose to the remaining Trustees the nature of such relationship" and "so long as a majority of all the Trustees have notice of such interest of such Trustee in such transaction and shall approve thereof." [R. 44-45.]

In view of all the foregoing it is respectfully submitted that the Tax Court applied correct legal principles embraced within Section 22(a) and the *Clifford* doctrine, that the Tax Court knew the theory and purpose back of the *Clifford* doctrine, and that it properly refused to permit the application of that doctrine to the very different facts and purposes involved in Chandler Trust No. 2.

III.

The Individual Respondents Are Not Taxable on the Stock Dividends Under the Commissioner's Regulations Defining the Scope of Helvering v. Clifford, 309 U. S. 331.

The Appendix to the Commissioner's brief does not set forth the regulations under Section 22(a) of the Internal Revenue Code having to do with the taxation of trust income to the grantor of a trust under the *Clifford* doctrine. Such regulations are lengthy and are set forth in full in the Appendix to this brief. They were added to the regulations by Treasury Decision 5488, C. B. 1946-1, 19 (26 C. F. R., 29.22(a)-21), and were amended by Treasury Decision 5567, C. B. 1947-2, 9, published in the Federal Register July 4, 1947.

The regulations provide that they shall be applicable in determining the taxability of trust income for taxable years beginning after December 31, 1945; and presumably for this reason the Commissioner's brief does not set them forth in the present case, which concerns the years 1938 through 1941. But we wish to point out that on the same day the regulations were amended, June 30, 1947, the Commissioner of Internal Revenue promulgated a ruling known as Mim. 6156, C. B. 1947-2, 13, in which reference is made to the fact that the regulations are applicable only to taxable years beginning after December 31, 1945, and where the following rule is announced:

> "* * * However, it will be the policy of the Bureau, where no inconsistent claims prejudicial to the Government are asserted by trustees or bene-

> ficiaries, not to assert liability of the grantor for any prior taxable year under the general provisions of section 22(a) of the Internal Revenue Code if the trust income would not be taxable to the grantor under the regulations as amended."

In other words, the Commissioner of Internal Revenue, who is the petitioner in the present case, has adopted the rule that if trust income would not be taxable to grantors of trusts under his regulations dealing with later years, he will not tax such grantors on the trust income for prior taxable years. Hence, if this Court should be of the opinion that the taxpayers are taxable upon the stock dividends in the absence of the regulations, we believe that a consideration of those regulations is appropriate to determine whether the tax is properly imposed under those regulations. The taxpayers made this contention before the Tax Court, but in view of the Court's decision that the taxpayers were not taxable in any event upon the stock dividends, it became unnecessary to consider the application of the regulations. See the Court's reference to this contention at the conclusion of its opinion. [R. 66-67.]

It will be observed from the regulations set forth in the Appendix hereto that the Bureau recognized that in the absence of precise guides supplied by regulation the application of the *Clifford* principle to varying and diversified factual situations

> "has led to considerable uncertainty and confusion. The provisions of this section accordingly resolve the present difficulties of application by defining and specifying those factors which demonstrate the retention by the grantor of such complete control of the trust that he is taxable on the income therefrom under Section 22(a). * * *"

The regulations then go on to specify the three factors, any one of which will cause income to be taxed to the grantor. The first factor applies to short-term trusts, having to do with reversions of corpus or income to the grantor within a period of 10 years or, under certain circumstances, 15 years.

This factor obviously has no application to the present case, for there is no reversionary interest to the grantors in the corpus of the trust or in the income (consisting of stock dividends) with which we are here concerned, they having been conveyed in trust for as long a period as is permitted by the laws of California.

The second factor subjects a grantor to tax upon income of a trust, regardless of its duration, if the beneficial enjoyment of the corpus or income is subject to a power of disposition by the grantor or any person not having a substantial adverse interest. But there are several limitations upon this factor, which take the present cases out of its scope. For instance, it is provided that:

> "* * * The grantor is not taxable, however, if the power, whether exercisable with respect to corpus or income, may only affect the beneficial enjoyment of the income for a period commencing 10 years from the date of the transfer (or 15 years * * *). * * *"

Another exception to the second factor is set forth in the following provisions:

> "The foregoing provisions of this paragraph shall not apply to any one or more of the following powers:
>
> (1) a power exercisable only by will, other than a power in the grantor to appoint the income of the trust where the income is accumulated for such

> disposition by the grantor, or may be so accumulated in the discretion of the grantor, or any person not having a substantial adverse interest in the disposition of such income, or both. For example, if a trust provides that the income is to be accumulated during the grantor's life and that the grantor may appoint the accumulated income by will, the grantor is taxable on the trust income * * *."

Thus, the regulations, as heretofore noted, draw the same distinction that at least five cases have drawn: a power to sprinkle income about during a grantor's lifetime renders the grantor taxable, as in the *Buck* and *Klein* cases; but a mere power to appoint after the grantor's death does not, as was held in the *Bateman, Pingree* and *Halliwell* cases, *supra.*

In the present case each grantor reserved the right to designate who shall enjoy the income from the property after his or her death and who shall ultimately receive his or her share of the corpus of the trust at its termination upon the death of the last survivor of 21 individuals. Hence, we submit that the individual grantors are not taxable upon the stock dividends in the present case, under the regulations, by virtue of the reserved power to appoint the beneficial enjoyment of the property after their respective deaths.

The third factor specified in the regulations is termed "Administrative Control." Trust income is taxable to a grantor if "administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiaries of the trust." But what is of particular significance is that the regulations go on to specify with great particularity what will be deemed to constitute "administrative

control exercisable primarily for the benefit of the grantor." It consists of:

(1) A power exercisable by the grantor or any person without a substantial adverse interest whereby the grantor or any person can purchase, exchange, or otherwise deal with or dispose of the corpus or the income of the trust "for less than an adequate and full consideration in money or money's worth."

(2) A power exercisable by the grantor or any person without a substantial adverse interest whereby the grantor can borrow the corpus or income, directly or indirectly, without adequate interest or without adequate security.

(3) Instances where the grantor has directly or indirectly borrowed the corpus or income and has not completely repaid the loan including interest before the beginning of the taxable year.

(4) Any one of the following powers exercisable in a "non-fiduciary capacity" by the grantor or any person without a substantial adverse interest: to vote or direct the voting of stock, to control the investment of trust funds, and to reacquire the trust corpus by substituting other property of an equivalent value.

The regulations then go on to provide that if a power is exercisable by a person as trustee, it is presumed that the power is exercisable in a "fiduciary capacity" primarily in the interests of the beneficiaries. And the regulations specify that the mere fact that a power exercisable by a trustee is described in broad language does not indicate that the trustee is authorized to purchase, exchange, or otherwise deal with or dispose of the trust property or income for less than an adequate and full consideration in money or money's worth, or is authorized

to lend the trust property to the grantor without adequate interest.

In the present case the Commissioner's brief contains much loose argument regarding what he calls "administrative control." It is asserted throughout his brief that powers have been reserved in Chandler Trust No. 2 which are intended to be exercisable by the taxpayers solely for their own selfish interests and without the usual fiduciary responsibility.

There is no merit whatever in these general and vague assertions. We believe it was incumbent upon the Commissioner, in view of desired uniformity of application of the law, to govern his allegations regarding administrative control by the standards which he himself has set up in the regulations. Nowhere in the trust instrument is there any authority or power on the part of any of the taxpayers in any capacity—whether as grantor, trustee or beneficiary—to acquire the trust corpus or the stock dividends or any part of them under any circumstances, let alone for less than an adequate and full consideration in money and money's worth. There is no power whatever in the trust instrument under which any of the grantors can borrow from the trust corpus or stock dividends, either with or without interest, and indeed such disposition of the trust corpus would violate the very purpose for which the trust was created and is specifically prohibited by the express language of the trust instrument and by the whole meaning of the document. Nor has any of the grantors borrowed any of the corpus or stock dividends at any time. And, finally, all powers dealing with investment and reinvestment of the trust corpus and the voting of stock constituting a part of the trust corpus are vested in trustees in their capacity as trustees. Under the wording of the regulations it is therefore presumed

that such powers are intended to be exercisable in a fiduciary capacity. And the regulations say that this presumption can be rebutted only by looking at the actual operation of the trust to see whether or not such powers have in fact been exercised in a non-fiduciary capacity.

We challenge the Commissioner to point to one circumstance in the operation of Chandler Trust No. 2 which would cast the slightest doubt upon the plain fact that the trust at all times has been administered in accordance with the very strictest fiduciary obligations. The trust agreement directs the trustees at all cost to preserve and protect the shares of stock that were delivered to them and to retain the proportionate interest which they represented in the two corporations. The trustees have meticulously adhered to that declaration. When stock dividends were received, which if distributed would have diluted the interests of the trust in the corporations, the trustees never for a moment had any thought other than obeying the direction of the trust instrument that such stock dividends should inure to and fall upon the principal and be treated as part of the trust estate for ultimate distribution to the remaindermen; and the stock dividends have always been so considered and so held as part of the trust corpus. In short, the activities of the trustees have in reality been confined to the receipt of taxable cash dividends upon the stocks which the trust owns and the distribution of such dividends to the beneficiaries of the trust as set forth therein. It will be observed that nowhere in the Commissioner's brief is there any allegation that any powers have been actually exercised by the trustees in anything but a fiduciary capacity. We find only vague assertions that the trustees can abuse their discretion, nullify the whole purpose and intent of creating the trust, and violate the fiduciary

responsibilities placed upon them. Such arguments run afoul of the Commissioner's own regulations, which we have summarized above.

The grantors of this trust, being persons of substance and character, created it to serve a bona fide and wholly legitimate purpose, with no thought whatever of income taxes or estate taxes. They have been content in the 15 years since it was created to abide by its terms and to carry it into faithful operation. We think it does not lie within the province of the Commissioner of Internal Revenue to take it upon himself to challenge the existence of the trust for tax purposes upon the assumption that these individuals will attempt to thwart its purpose and violate all the rules and canons of fiduciary responsibility. They would have no purpose to do so even were it permissible under the laws of California, which it is not.

Conclusion.

The opinion and decisions of the Tax Court were in all respects sound and should be affirmed.

Dated October 17, 1950.

Respectfully submitted,

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APPENDIX.

Internal Revenue Code:

"SEC. 22. GROSS INCOME.

(a) General Definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

"SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; * * *

* * * * * * * *

then such part of the income of the trust shall be included in computing the net income of the grantor."

The corresponding Sections of the Revenue Act of 1938 were substantially the same.

Treasury Regulations 111, Section 29.22(a)-21 is as follows:

"SEC. 29.22(a)-21. TRUST INCOME TAXABLE TO THE GRANTOR AS SUBSTANTIAL OWNER THEREOF—*(a) Introduction.*—Income of a trust is taxable to the grantor under section 22 (a) although not payable to the grantor himself and not to be applied in satisfaction of his legal obligations if he has retained a control of the trust so complete that he is still in practical effect the owner of its income. *Helvering v. Clifford,* 309 U. S. 331. In the absence of precise guides supplied by an appropriate regulation, the application of this principle to varying and diversified factual situations has led to considerable uncertainty and confusion. The provisions of this section accordingly resolve the present difficulties of application by defining and specifying those factors which demonstrate the retention by the grantor of such complete control of the trust that he is taxable on the income therefrom under section 22(a). Such factors are set forth in general in paragraph *(b)* and in detail in paragraphs *(c), (d)* and *(e)*, below.

(b) In general.—In conformity with the principle stated in paragraph *(a)* above, the income of a trust is attributable to the grantor (except where such income is taxable to the grantor's spouse or former spouse under section 22 (k) or 171 if—

(1) the corpus or the income therefrom will or may return after a relatively short term of years (see paragraph *(c)*);

(2) the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition (other than certain excepted powers), whether by revocation, alteration or otherwise, exercisable by

the grantor, or another person lacking a substantial adverse interest in such disposition, or both (see paragraph *(d)*); or

(3) the corpus or the income therefrom is subject to administrative control, exercisable primarily for the benefit of the grantor (see paragraph *(e)*).

(c) Reversionary interest after a relatively short term.—Income of a trust is taxable to the grantor where the grantor has a reversionary interest in the corpus or the income therefrom which will or may reasonably be expected to take effect in possession or enjoyment—

(1) within 10 years commencing with the date of the transfer, or

(2) within 15 years commencing with the date of the transfer if the income is or may be payable to a beneficiary other than a donee described in section 23 (o) and if any one or more of the following powers of administration over the trust corpus or income are exercisable solely by the grantor, or spouse (living with the grantor, and not having a substantial adverse interest in the corpus or income of the trust), or both, whether or not exercisable as trustee: a power to vote or direct the voting of stock or other securities, a power to control the investment of the trust funds either by directing investments or reinvestments or by vetoing proposed investments or reinvestments, and a power to reacquire the trust corpus by substituting other property, whether or not of an equivalent value.

Where the grantor's reversionary interest is to take effect in possession or enjoyment by reason of some event other than the expiration of a specific term of years, the

trust income is nevertheless attributable to him if such event is the practical equivalent of the expiration of a period less than 10 or 15 years, as the case may be. For example, a grantor is taxable on the income of a trust if the corpus is to return to him or his estate on the graduation from college or prior death of his son, who is 18 years of age at the date of the transfer in trust. Trust income is, however, not attributable to the grantor where such reversionary interest is to take effect in possession or enjoyment at the death of the person or persons to whom the income is payable.

In general, a reversionary interest may reasonably be expected to take effect in possession or enjoyment within 10 or 15 years. as the case may be, where the corpus or the income therefrom is to be reacquired if the grantor survives any stated contingency which is of an insubstantial character. Thus, the grantor is taxable where the trust income is to be paid to the grantor's wife for three years, and the corpus is then to be returned to the grantor if he survives such period, or to be paid to the grantor's wife if he is already deceased.

Any postponement of the date specified for the reacquisition of possession or enjoyment of the reversionary interest is considered a new transfer in trust commencing with the date on which the postponement is effected and terminating with the date prescribed by the postponement. But income for any period shall not be taxable to the grantor by reason of the preceding sentence if such income would not be taxable to him in the absence of such postponement.

Example. A places property in trust for the benefit of his son B. Upon the expiration of 12 years or the earlier death of B the property is to be paid over to A

or his estate. Neither A nor his wife has any power of administration over the trust corpus or income. After the expiration of nine years A extends the term of the trust for an additional two years. A is considered to have made a new transfer in trust for a term of five years. He is not taxable on the income for the first three years of such term because he would not be taxable thereon if the term of the trust had not been extended. A is taxable, however, on the income for the remaining two years.

(d) Power to determine or control beneficial enjoyment of income or corpus.—Income of a trust is taxable to the grantor where, whatever the duration of the trust, the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition (except as provided in section 167 (c) and as hereafter provided in subparagraphs (1) to (4), inclusive), whether by revocation, alteration, or otherwise, exercisable (in any capacity and regardless of whether such exercise is subject to a precedent giving of notice or is limited to some future date) by the grantor, or any person not having a substantial adverse interest in the beneficial enjoyment of the corpus or income, whichever is subject to the power, or both. The grantor is not taxable, however, if the power, whether exercisable with respect to corpus or income, may only affect the beneficial enjoyment of the income for a period commencing 10 years from the date of the transfer (or 15 years where any power of administration specified in paragraph *(c)* is exercisable solely by the grantor, or spouse living with the grantor and not having a substantial adverse interest, or both, whether or not as trustee). For example, if a trust created on January 1, 1940 provides for the payment of

income to the grantor's wife, and the grantor does not reserve any such administrative power but reserves the power to substitute other beneficiaries in lieu of his wife on or after January 1, 1950, the grantor is not taxable on the trust income for the period prior to January 1, 1950. But the income will be attributable to the grantor for the period beginning on such date unless the power is relinquished. If the beginning of such period is postponed, such postponement is considered a new transfer in trust commencing with the date on which the postponement is effected and terminating with the date prescribed by the postponement. But income for any period shall not be taxable to the grantor by reason of the preceding sentence if such income would not be taxable to him in the absence of such postponement. Where the income affected by the power is for a period beginning by reason of some event other than the expiration of a specific term of years, the grantor will be taxable if such event is the practical equivalent of the expiration of a period less than 10 or 15 years, as the case may be, in accordance with the criteria stated in paragraph *(c)*.

The foregoing provisions of this paragraph shall not apply to any one or more of the following powers:

(1) a power exercisable only by will, other than a power in the grantor to appoint the income of the trust where the income is accumulated for such disposition by the grantor, or may be so accumulated in the discretion of the grantor, or any person not having a substantial adverse interest in the disposition of such income, or both. For example, if a trust provides that the income is to be accumulated during the grantor's life and that the grantor may appoint the accumulated income by will, the grantor is taxable on the trust income;

(2) a power to determine the beneficial enjoyment of the corpus or the income therefrom if such corpus or income, as the case may be, is irrevocably payable for the purposes and in the manner specified in section 23 (o);

(3) If (i) the power is exercisable by a trustee or trustees, none of whom is the grantor, spouse living with the grantor, or a related or subordinate trustee of the type and under all the conditions referred to in subparagraph (4) (ii), and (ii) the exercise of the power is not subject to the approval or consent of any person other than such trustee or trustees, this paragraph shall not apply to a power—

(A) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries,

(B) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries).

The powers herein described include all the powers described in subparagraph (4), since the latter powers are more limited than those herein described.

(4) If the power—

(i) is exercisable by the grantor or spouse living with the grantor, or both, whether or not as trustee, or

(ii) is exercisable (A) solely by a trustee or trustees who include the father, mother, issue, brother, sister, or employee of the grantor, or a subordinate employee of a corporation in which the grantor is an executive or in which the stockholdings of the grantor and the trust are significant from the

viewpoint of voting control, and (B) in a manner which may effect the interests of beneficiaries which include the spouse or any child of the grantor (see subparagraph (3) for a power exercisable by a related or subordinate trustee of the class hereinabove described where the exercise of the power does not affect the interest of the spouse or a child of the grantor or where the power is exercisable only with the concurrence of an unrelated and nonsubordinate trustee), or

(iii) is exercisable by any person or persons other than as trustee, or

(iv) is exercisable by any trustee or trustees, and the exercise of the power is subject to the approval or consent of any person or persons (other than such trustee or trustees), or of the grantor or spouse living with the grantor, or both, in the capacity of trustee,

this paragraph shall not apply—

(aa) to a power to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries), provided that the power is limited by a reasonably definite external standard. Such standard must be set forth in the trust instrument and must consist of needs and circumstances of the beneficiaries;

(bb) if the power is not limited by a reasonably definite external standard, to a power to pay out corpus to or for any current income beneficiary, provided that any such payment of corpus must be chargeable against the proportionate share of corpus held in trust for the payment of income to such beneficiary as if such corpus constitutes a separate trust;

(cc) to a power to distribute or apply income to or for any current income beneficiary or to accumulate such income for him, provided that any accumulated income must ultimately be payable to the beneficiary from whom distribution or application is withheld, to his estate, or to his appointees (or persons named as alternate takers in default of appointment) provided that such beneficiary possesses a power of appointment which does not exclude from the class of possible appointees any person other than the beneficiary, his estate, his creditors or the creditors of his estate; or, if payable upon the termination of the trust or in conjunction with a distribution of corpus which distribution is augmented by such accumulated income, is ultimately payable to the current income beneficiaries in shares which have been irrevocably specified in the trust instrument. Accumulated income shall be considered so payable although it is provided that if any beneficiary does not survive a date of distribution which may reasonably be expected to occur within the beneficiary's lifetime, the share of such deceased beneficiary is to be paid to such persons as the beneficiary may appoint, or is to be paid to one or more designated alternate takers (other than the grantor or the grantor's estate) if the share of such alternate taker or the shares of such alternate takers have been irrevocably specified in the trust instrument;

(dd) to a power, exercisable only during *(1)* the existence of a legal disability of any current income beneficiary, or *(2)* the period in which any income beneficiary shall be under the age of twenty-one years, to distribute or apply income to or for such

beneficiary or to accumulate and add such income to corpus;

(ee) in a case falling under subdivision (ii) hereof, to a power to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, whether or not the conditions in subdivision (cc) or (dd) are satisfied, provided that such power is limited by a reasonably definite external standard. For the requirements of such standard, see subdivision (aa) hereof.

A power does not fall within the powers described in subparagraphs (3) and (4) if the trustee is enabled to add to the class of beneficiaries designated to receive the income or corpus, except insofar as provision may be made for after-born or after-adopted children. A mere power to allocate receipts as between corpus and income, even though expressed in broad language, is not deemed a power over beneficial enjoyment with respect to income or corpus.

(e) Administrative control.—Income of a trust, whatever its duration, is taxable to the grantor where, under the terms of the trust or the circumstances attendant on its operation, administrative control is exercisable primarily for the benefit of the grantor rather than the beneficiaries of the trust. Administrative control is exercisable primarily for the benefit of the grantor where—

(1) a power exercisable by the grantor, or any person not having a substantial adverse interest in its exercise, or both, whether or not in the capacity of trustee, enables the grantor or any person to purchase. exchange or otherwise deal with or dispose of the corpus or the income therefrom for less than an

adequate and full consideration in money or money's worth; or

(2) a power exercisable by the grantor, or any person not having a substantial adverse interest in its exercise, or both, whether or not in the capacity of trustee, enables the grantor to borrow the corpus or income, directly or indirectly, without adequate interest in any case, or without adequate security except where a trustee (other than the grantor or spouse living with the grantor) is authorized under a general lending power to make loans without security to the grantor and other persons and corporations upon the same terms and conditions; or

(3) the grantor has directly or indirectly borrowed the corpus or income, and has not completely repaid the loan, including any interest, before the beginning of the taxable year; or

(4) any one of the following powers of administration over the trust corpus or income is exercisable in a nonfiduciary capacity by the grantor, or any person not having substantial adverse interest in its exercise, or both: a power to vote or direct the voting of stock or other securities, a power to control the investment of the trust funds either by directing investments or reinvestments or by vetoing proposed investments or reinvestments, and a power to reacquire the trust corpus by substituting other property, of an equivalent value.

If a power is exercisable by a person as trustee, it is presumed that the power is exercisable in a fiduciary capacity primarily in the interests of the beneficiaries. Such presumption may be rebutted only by clear and convincing

proof that the power is not exercisable primarily in the interests of the beneficiaries. If a power is not exercisable by a person as trustee, the determination of whether such power is exercisable in a fiduciary or a nonfiduciary capacity depends on all the terms of the trust and the circumstances surrounding its creation and administration. For example, where the trust corpus consist of diversified stocks or securities of corporations the stock of which is not closely held and in which the holdings of the trust, either by themselves or in conjunction with the holdings of the grantor, are of no significance from the viewpoint of voting control, a power with respect to such stocks or securities held by a person who is not a trustee will be regarded as exercisable in a fiduciary capacity primarily in the interests of the beneficiaries. Where the trust corpus consists of stock or securities of a closely-held corporation, such a power may or may not, depending upon all the facts, be considered exercisable in a fiduciary capacity.

The mere fact that a power exercisable by the trustee is described in broad language does not indicate that the trustee is authorized to purchase, exchange or otherwise deal with or dispose of the trust property or income for less than an adequate and full consideration in money or money's worth, or is authorized to lend the trust property or income to the grantor without adequate interest. On the other hand, such authority may be indicated by the actual administration of the trust.

(f) Limitations of section.—Despite the limitations of this section, the grantor of a trust directing the payment or application of the income therefrom in satisfaction of the grantor's legal obligations shall continue to be taxable on the income. The grantor may also be taxable on the

income of a trust on the ground that such income is attributable to him in a capacity unrelated to dominion and control over the trust as such are defined in subsections *(c)*, *(d)* and *(e)* of this section. Thus, the provisions of this section do not affect the principles governing the taxability of future income to the assignor thereof whether or not the assignment is by means of a trust. Nor, for example, do the provisions of this section affect the applicability of section 22(a) to the creator of a family partnership. See further sections 166 and 167.

Section 22(a) shall be applied in the determination of the taxability of trust income for taxable years beginning prior to January 1, 1946 without reference to this section."